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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

NHS REVIEW: SUPPLY AND DEMAND

In the work we are doing on the review, it is vital that we do not lose sight of some of the basic features of the economics of health care.

Put simply, the demand for health care exceeds the supply. In the public sector, that is inevitable: with a "free" service financed out of general taxation, demand will always be virtually unlimited. Hence the persistence of waiting lists. Our objective for the public sector must be to see that, despite the absence of the price mechanism, it provides health care as efficiently and effectively as possible, and we get the best possible output for the money we put in.

In the private sector, there is a price mechanism. But prices are too high, because of inefficiencies in supply and restrictive practices by the medical profession - for example, the rule that all operations must be carried out by consultants. Our objective for the private sector must be to improve the supply performance and hence bring down prices and encourage growth.

Some of the measures we are considering, in particular on the tax side, would add to demand. But if we simply boost demand without improving supply, the inevitable result will be higher prices and little real growth in private health care. No one will thank us for that, except the professionals whose pay will go up.



So the priority must be the supply side. This is exactly the prescription we have successfully followed in many other areas of policy. There is no reason why health should be any different. Indeed, if anything the case for supply side reforms is even stronger.

In the NHS, prices and charges play a negligible role, particularly in the hospital service. Indeed, charges now raise only 3½ per cent of the costs of the NHS, compared with 5 per cent in the 1950s. So patients (and their doctors too) will always tend to press for high-cost options.

Doctors have no incentive to be cost-conscious. Budgeting and information systems in the NHS are ill-designed. Those who commit resources are not financially accountable nor are they given adequate information on the costs of what they are doing. Doctors everywhere cling to the outmoded belief that they should not be involved in the management of resources.

It is not surprising that this produces a chronic tendency to stimulate demand which cannot be satisfied. We are looking at ways in which we can improve efficiency in the NHS and enable it to meet more of the demands on it. But we shall also be looking to an expanding private sector to meet more of this demand.

This is already happening. Since we last discussed this my officials have obtained more up to date statistics. The evidence is striking. For example, Private Patients Plan (PPP) report that their subscriptions grew by 20% in the first few months of this year, which was the whole of their earlier planned growth expectation for the two years 1988 and 1989. BUPA say that they are planning on the basis of a doubling in the number of subscriptions over the next two years.



It is clear that, in the private sector, shortage of demand is not the problem. The companies themselves recognise that they are fully stretched. In these circumstances, boosting demand further without doing anything to improve supply will simply raise prices. Pay rates will go up, and this will inevitably read across to staff costs in the NHS.

This is the last thing we want. We must concentrate not on boosting the demand but on making sure that the private health sector can respond. At the moment it, too, suffers from restrictive practices and other inefficiencies: too much work, for example, is done at too senior a level, particularly by consultants. And many of the problems of a lack of cost-consciousness also apply in the private sector. There is, too, a clear limit to how fast the private sector can expand without bidding scarce staff away from the public sector. Recruiting and training new staff will inevitably take time.

In putting together a credible and coherent package of reforms, what we must do is work carefully through the supply and demand consequences. There is no need to underline the crucial importance of getting this right.

I am copying this minute to John Moore, John Major, Tony Newton, Sir Roy Griffiths and Sir Robin Butler.

Muir Wallace

pp [N.L.]

28 June 1988

(Approved by the Chancellor
and signed in his absence.)